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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Yugoslav Economic Policy Under Sirotkovic:
"No Magic Solutions"

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ER IM 73-21
February 1973

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1973

INTELLIGENCE MEMORANDUM

YUGOSLAV ECONOMIC POLICY UNDER SIROTKOVIC: "NO MAGIC SOLUTIONS"

INTRODUCTION

1. Jakov Sirotkovic, Vice President of Yugoslavia's Federal Executive Council and currently the architect of Yugoslav economic policy, will be in the United States during the week of 11-17 February to discuss the status of Yugoslav-US economic relations. This memorandum looks at the results of two years of policymaking under Sirotkovic as they affect the prospects for Yugoslavia's economy and for US-Yugoslav economic relations.

SUMMARY AND CONCLUSIONS

2. After his two years in charge of Yugoslav economic policymaking, Jakov Sirotkovic is beginning to see some results in combating one of the country's worst periods of economic crisis. A rare balance-of-payments surplus was generated in 1972, and new credit and even wage controls were imposed at the end of the year in the continuing battle against inflation and enterprise insolvency. He is by no means out of the woods, but at least his current talks in Washington can focus on measures to improve US-Yugoslav commercial relations, rather than on emergency US financial assistance.

3. Since 1965, the US role has shifted from direct aid in support of economic growth and reform to efforts to expand normal trade and commercial relations. Trade has not yet responded to the change in policy; overall trade, except for special large US export deals such as recent wheat and aircraft sales, has nearly stagnated during the last half of the 1960s. In contrast, Yugoslav trade with the USSR has revived sharply since 1970,

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Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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reflecting Yugoslavia's hard currency balance-of-payments difficulties. The upsurge in trade was accompanied by $540 million in Soviet credits for resource development in Yugoslavia's backward areas.

4. Neither Sirotkovic's latest package of stabilization measures nor the current liberalization of Yugoslav imports is expected to have a significant effect on US-Yugoslav trade in the next year or two. In the longer run, trade expansion would be encouraged by US support for joint ventures and long-term credit arrangements, particularly those that promote Yugoslav exports. Prospects for trade would be brighter if Sirotkovic could convert his emergency stabilization program into a systematic set of rules for the economy, designed to prevent instability and speculation, not merely to react to crises already under way. But the odds are against this, especially now that the republics have primary responsibility for implementing federal policies. Once the economic picture improves, nearly everyone will again demand that controls be dismantled. This will put the economy into another cycle of instability and probably will put Yugoslav policymakers on the road to Washington for another round of talks on debt rescheduling.

DISCUSSION

Background

5. When Jakov Sirotkovic became a Vice President of the Federal Executive Council (FEC)[1] in in December 1970, the political atmosphere was so charged that Premier Ribicic expressed pleasure to have found "someone at all ... who will accept this job." The man he found, however, was by no means a choice of last resort. A Croat, he combined the qualifications of a World War II partisan and those of a widely experienced economic official and academician. Sirotkovic received his doctorate in economics from Zagreb University in 1951, studied at

1. Sirotkovic now heads both the FEC's Commission for Economic Policy (appointed September 1971) and Commission for Coordination of Work on Distribution and Expanded Production (formed September 1972).

the London School of Economics (1954-55) and at the University of California at Berkeley (1965). He worked as an economic planner in Croatia as early as 1952. In 1962, he gave up the directorship of the Economic Council of Croatia to become one of the directors of the Federal Planning Institute. During 1966-70, Sirotkovic served briefly as Rector of Zagreb University, as a member of the FEC Economic Council, as a representative to the United Nations Committee for Development Planning, and as editor-in-chief of the Yugoslav magazine **Ekonomist**.

6. Sirotkovic could not have become the government's leading economic policymaker at a less favorable time. Yugoslavia's balance-of-payments position was rapidly deteriorating, domestic inflation was accelerating, and a growing number of enterprises and banks were becoming insolvent. Measures to curb excessive investment and import growth were being resisted from all quarters. In addition, the government was trying to implement a major political decentralization, and the impending shakeup of federal powers and personnel created an air of indecision in Belgrade. Squabbling among economic policymakers and the failure to produce a concrete economic stabilization program proved to be too much for Sirotkovic's predecessor, Nikola Miljanic, who dramatically resigned in November 1970.

7. At a conference of economists in 1968, Sirotkovic had called for a critical examination and full public discussion of the state of the economy, which he believed might lead to major changes in economic policy. Since he has held the reins, Sirotkovic has presented the public with a candid account of the state of the economy, and he has freely discussed policy failures as well. The stabilization program inherited from Miljanic at the end of 1970 has been greatly expanded during Sirotkovic's two years of leadership, although, as he admitted in September 1972, it still shows only "modest" results. The basic policy dilemmas remain unresolved: how the leadership can balance trade and fight inflation and at the same time spur growth in the backward areas, promote economic decentralization, and continue subsidizing so many inefficient firms.

8. Economic policy conflicts have spilled over into the political arena -- and into the Party, which seemed paralyzed by the 1970-71 decentralization. The decentralization created widespread disarray in Party ranks, providing an opening for Croat and, to a lesser degree, Slovene leaders to push for even greater economic autonomy at the expense of the federation and to criticize loudly Belgrade's regional development policies for the poorer southern areas.

9. When students at Zagreb University took up the Croat leaders' theme, airing the Party's dirty laundry in the streets during a general protest strike in November 1971, Tito had had enough. What began as a shuffle

of principal federal functions and functionaries turned into a wholesale purge of regional Party bosses. The Croat leaders were the first to go – Miko Tripalo, Piro Pirker, and Savka Dabcevic-Kucar. Later, Tito sacked Premier Kavcic of Slovenia and Party chief Nikezic of Serbia, both accused, with good reason, of similarly putting regional economic and political interests above those of the federation. Tito also turned on the business community, trying to expose "capitalists" who were amassing wealth and buying villas. But he stopped short of engineering widespread dismissals, probably because his actions were already causing runs on the banks -- and not only by the "wealthy" -- in Belgrade and other cities. Through all of this, Tito has reasserted the need for tighter central Party direction in the economy as well as in politics. But this has not made Sirotkovic's job any easier – basic disagreements on economic policy among the republics and their representatives in Belgrade continue to keep Tito's chief economist on the hot seat.

Balancing Trade

10. Once in charge, Sirotkovic gave top priority to alleviating the balance-of-payments crisis of 1970-71. He was both more careful and more persistent than his predecessor. He tried so far as possible to do without the heavy-handed controls that had produced recession in 1966-67. He kept in view the "political" balance that Tito has sought to maintain in trade between East and West, and resisted the constant demand from Yugoslav industries and regional governments for special trade treatment. As it was, the federal government was forced to implement progressively tighter controls and also to shift some of its imports away from Western hard currency markets to the USSR and other "soft currency" trade partners. Import restrictions in July 1971 and a crackdown on domestic credit sales of imported goods cut the demand for Western imports. Meanwhile, enterprises were encouraged to purchase raw and semifinished materials from the USSR. As a result, imports from the USSR increased by 46% in 1971, producing Yugoslavia's first deficit on clearing account with that country since 1962. (Yugoslav trade, by geographic area, is shown on the map).[2]

11. The upshot of these policies – helped by good gains in export receipts – was a rare balance-of-payments surplus in 1972 of about $185 million, mostly in hard currency.[3] The surplus reflected a 5% drop in imports, an 18% boost in exports, and another large increase in earnings from tourism and worker remittances. Although small relative to Yugoslavia's $2.5 billion medium-term and long-term hard currency debt, the surplus was large enough to clean up a portion of Yugoslavia's excessive

2. All trade data are from official Yugoslav statistics.

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YUGOSLAVIA: Trade Turnover by Geographic Area, 1971

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short-term commercial indebtedness in Western Europe. Aided by the surplus and new foreign loans, Yugoslavia's end-of-year foreign exchange reserves reportedly went up to $800 million, compared with only $282 million at the end of 1971. Additional breathing space was provided by the rescheduling in 1971 of nearly $300 million in debt repayments to Western creditors, including about $60 million to the United States.

12. The reprieve may be short. As in 1966-67, following the 1965 surplus, Belgrade is again liberalizing import controls. The government hopes that gradual implementation and a tight import credit policy will prevent a repeat of the rush to buy "Western" after the 1967 liberalization. The

1967 import binge took place even though the economy was in a severe recession; this time the liberalization takes effect when enterprise stocks are generally at low levels. The government's policy options are limited; if enterprises are not allowed to rebuild their depleted stocks, another recession could be in the cards. On the other hand, easing the reins on credits might open the door to another import surge.

13. Also clouding balance-of-payments prospects for 1973 is the slowdown in the departures of workers for Western Europe that occurred during 1972. Tito himself recently declared, "too much emphasis has been put on the hard currency flow from the workers abroad while it has been forgotten that 300,000 men eligible for military duty" are abroad. Accordingly, on 5 February 1973 a government resolution was passed which is aimed at reducing the outflow of skilled workers and those workers who are of military age. A leveling off of worker remittances -- which brought in $850 million, or almost two-thirds as much as Yugoslavia earned from hard currency exports in 1972 -- could dash hopes of achieving another balance-of-payments surplus this year and threatens to cause another balance-of-payments crisis in the mid-1970s, when hard currency debt repayments will again bulge. Nevertheless, with one finger in the payments gap, Sirotkovic is now turning his attention to domestic problems.

Inflation and Insolvency

14. After two years of struggling with inflation and enterprise illiquidity, Sirotkovic has been able to convince the leadership that excessive wage increases as well as unfunded investments must be attacked. In 1970, investment rose by 32%, but restrictive measures have since held increases to only 8% in 1971 and 13% in 1972. Meanwhile, average wages, which were unrestrained, grew rapidly -- by 17% in 1970, 22% in 1971, and at least 19% in 1972. With this kind of wage pressure, it was little wonder that restrictive credit measures directed solely against investment aggravated enterprise illiquidity without slowing the rise in the cost of living, which went up by 16% in both 1971 and 1972.

15. Insolvency in the Yugoslav economy reached such critical proportions that Sirotkovic complained that "no system ... can function in such a state of illiquidity." After a long series of ineffective price controls and widely ignored wage guidelines, the FEC in December 1972 rammed through several highly unpopular measures, including a wage cut of 10% in insolvent enterprises, a salary freeze for government workers, and another round of restrictions on enterprise investment. It is not clear that these measures will work. Republics have been given the authority to remit enterprise taxes or, reportedly, even to grant subsidies to offset the scheduled pay cut. Moreover, the government wage freeze might provide republics and communes with spare funds to bail out enterprises in trouble.

Decentralization and the Regional Question

16. Since the constitutional revision of 1968, which transferred much federal economic power to the republics, federal economic policies have been harder to enact and enforce. All direct federal investment now has been abolished, except for a few major projects in less developed areas, and "national" banks have been set up in all republics, with their directors making up the board of governors of the central National Bank. More important, the republics now have the primary authority for carrying out economic policy. And at times they have bent the rules. For example, the wage guidelines established in December 1970 were scarcely enforced – the actual increase in wages in 1971 was 22%, or double the 11% rate specified -- and apparently only Croatia came close to observing the 10.8% limit placed on federal and republic budgetary spending increases in 1971. As Sirotkovic had anticipated in March 1971:

> In several spheres, in the system, in the plan, and in our current policy, problems are so intricate that the Federal Executive Council will not be able to overcome them, unless it is supported in an appropriate way ... we need above all a political influence aimed at preserving the atmosphere of constructive cooperation, which is necessary in the effort to find joint solutions ... .

17. "Constructive cooperation" among the republics has been especially lacking in efforts to settle regional development issues. The south, still trying to catch up with the north, needs a strong federal hand for reallocating financial resources to support its growth. The north, which would rather have a sink-or-swim policy for all regions than see too much of its money siphoned off to the south, favors a weaker federal government. Under Sirotkovic, as during the entire postwar period, the north-south gap has continued to widen, even though the south continued to receive large injections of investment and foreign exchange. Since 1969, only Macedonia of the less developed areas has grown as fast as the national average in per capita income, while the most advanced republics (Slovenia and Croatia) have grown faster than the average. Per capita income in Kosovo, the most backward area, has fallen to 32% of the national average from more than 50% of the average in 1947.

18. Massive Soviet assistance, which accompanied the upsurge in trade in 1971, probably will improve the south's chances for development. A credit line of about $540 million has been set up to develop production of aluminum, minerals, power, and automobiles in the backward areas. The credit deals should further Belgrade's objectives of regional development without adding to the burden of the north. Even so, Sirotkovic, who took

a leading part in negotiating the credits, has admitted that there was some internal criticism of expanding trade with the USSR. The new deals do conform to longstanding Soviet aims of gaining a foothold in Yugoslavia's less developed areas. For example, the terms of a $130 million Soviet credit for an alumina combine in Bosnia-Hercegovina will bind the new plant to deliver all alumina plus 500,000 metric tons of bauxite to the USSR over a period of ten years. Ironically, aluminum products are one of Yugoslavia's best potential hard currency exports.[4]

The US Role

19. In contrast to Soviet policy, recent US efforts to aid the Yugoslav economy have focused mainly on commercial aspects of economic assistance rather than direct aid as in the 1950s. The US government did play a key role in encouraging the Yugoslavs to implement the major economic reforms of 1965 and 1967, but direct US aid ended after the 1966 Findley-Belcher Amendment to the Food for Peace Bill, which prohibited all PL-480 concessional agricultural sales to countries with ships calling in Cuban ports. Since then, the US role has been reduced mainly to widening the availability of the Export-Import Bank and other credit facilities to Yugoslav banks and to providing periodic debt rescheduling – most recently in 1971 – to ease Yugoslavia's recurring balance-of-payments pressures. The United States has also exercised its influence in the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) to build support for Yugoslavia in its efforts to obtain standby credits and long-term development loans. Total US assistance to Yugoslavia since 1946 has been about $3 billion, including grants under the United Nations' Relief and Rehabilitation Agency, military loans and grants, PL-480 loans, and Export-Import Bank credits. The IMF has provided another $400 million in various standby credits, and Yugoslavia has received $585 million in IBRD loans for long-term development projects -- the eighth largest total among the bank's borrowers.

20. Compared with the sustained boom in Yugoslavia's trade with its major West European partners, Italy and West Germany, US-Yugoslav trade turnover during the 1960s has been very erratic (as shown in the chart), most of the movement being accounted for by special US export deals. In the first half of the decade, wheat sales under PL-480 accounted for about 36% of total US exports to Yugoslavia. After the Findley Amendment was passed in 1966, total exports declined precipitously, from $199.8 million in 1966 to only $90.1 million in 1968. US exports of chemicals, machinery and transport equipment, and consumer manufactures since 1966 have declined steadily as a share of Yugoslav imports. For

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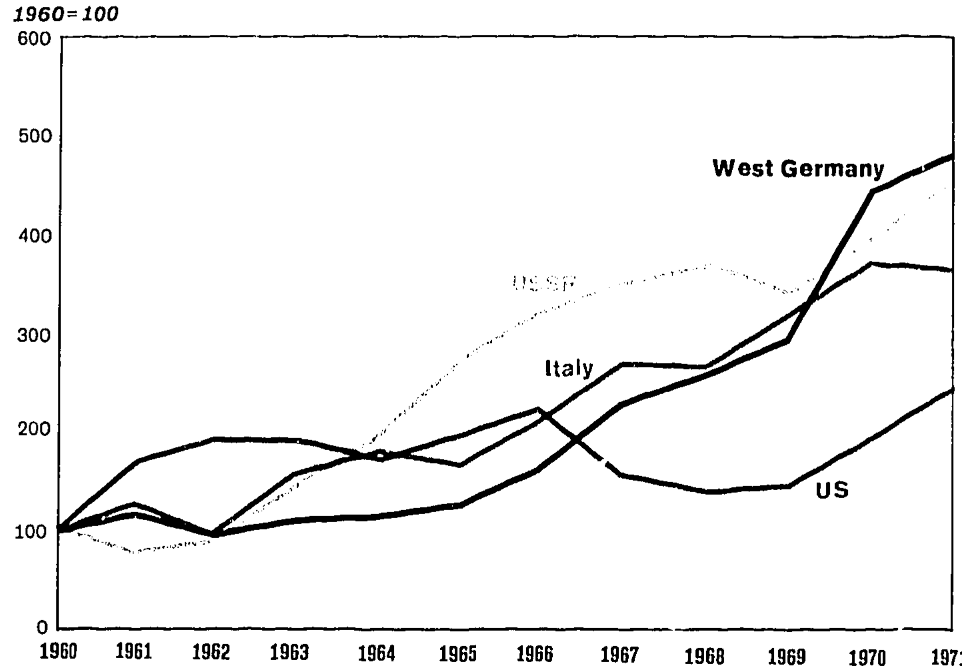
YUGOSLAVIA: Trade Turnover with Major Partners



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instance, even with the extraordinary sale of more than $70 million in aircraft and parts in 1970-71, US exports of machinery and transport equipment fell from 9.5% of total Yugoslav machinery imports in 1966 to only 3.5% in 1971. A bad harvest in 1970, and the increased availability of Commodity Credit Corporation (CCC) assistance, provided an impetus to 1971 agricultural imports from the United States, which shot up to $104 million. Total US exports to Yugoslavia, however, increased to only about $197 million -- still at the 1966 level. The commodity composition of US-Yugoslav trade is shown in the table.

21. Despite the recent boost in US exports, US-Yugoslav trade turnover accounted for only about 6% of Yugoslavia's total trade in 1972 -- down from 15.3% in 1961. From 1961 to 1972 the Yugoslavs ran a cumulative deficit of more than $1.1 billion with the United States. This deficit has been a factor in limiting imports from the United States. Although an even larger cumulative deficit resulted from trade with West Germany, remittances from the more than 500,000 Yugoslavs employed in West Germany and large earnings from West German tourists have largely financed the trade deficits. In contrast, earnings from US tourism are still relatively small -- about 551,000 Americans visited Yugoslavia in 1971 and probably accounted for $15 million to $20 million of the $355 million earned by the Yugoslav tourist sector.

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Yugoslavia: Composition of Trade with the United States
1971

	Exports		*Imports*	
	Total	*To US*	*Total*	*From US*
				Million US $
Total	**1,814**	**109**	**3,252**	**197**
Food, beverages, tobacco, oils and fats	323	20	346	104
Raw materials	148	2	312	20
Fuels	20	0	193	12
Chemicals	129	3	297	11
Semimanufactures	494	38	916	10
Machinery	445	8	1,018	36
Consumer goods and other	255	38	170	4

22. Although Yugoslav exports to the United States more than tripled during the 1960s, sales have slowed since 1968. Except for a few product lines, Yugoslav exporters have been unable to capture a significant share of the US market. Traditional exports of furniture and wood products earn about $24 million annually, and sales of semifinished copper products – such as cable, wire, and electrodes – added another $20 million in 1971. The more sophisticated products of Yugoslavia's industrial sector such as consumer durables, electrical machinery, transport equipment, and synthetic fibers are not yet up to the quality standards of the US market. Although many of these products are produced with Western machinery, most of the goods are unloaded in Eastern Europe or in the USSR.

23. Since the ending of direct aid in 1966, there has been a more or less tacit understanding between the two countries that trade expansion and encouragement of private investment would serve as the main vehicle for expanded economic relations. While trade promotion efforts thus far are barely off the ground, the recent extension of wider and more flexible Export-Import Bank financing facilities – such as the Cooperation Financing Facility (CFF) allowing Export-Import Bank financing of deals involving less than $1 million – improves somewhat the prospects for US exports. Moreover, US government help in encouraging private credits, such as the $100 million untied consortium loan arranged in April 1972 under the leadership of Bankers Trust of New York, will further improve US trade prospects.

24. Perhaps most important to future Yugoslav-US economic relations – at least to the Yugoslavs – is US government support for joint ventures. Coverage under the Overseas Private Investment Corporation formally went into effect on 18 January 1973, but many obstacles still remain. Since Yugoslavia adopted its foreign investment law in 1967, the flow of Western capital has been disappointing – only about $90 million in hard currency had been realized by mid-1972. US participation in joint investment is only about $3 million in direct company investment. although the inclusion of International Finance Corporation (IFC) loans brings the total up to a more respectable $16 million.[5] The Yugoslav law currently limits capital participation of the foreign investor to 49%, although, by special permission of the Secretariat for Finance, a 50-50 capital split was arranged in March 1972 between the Sevojno copper enterprise and the US firm Bieler Industries.

25. The Yugoslavs have been negligent in pointing out attractive investment possibilities to US firms. When negotiations have taken place, they have been protracted and often unsuccessful. For example, it took Ford more than three years to negotiate a joint tractor assembly deal with a Croat consortium which netted only a $600,000 sale of 50 disassembled tractors. Also, Kaiser-Energoinvest discussions on an aluminum combine – the same sort of facility now being built by the USSR -- dragged on for more than a year and then collapsed.

Prospects

26. Yugoslavia's short-run efforts to hold down inflation and preserve some of last year's balance-of-payments gains will not have impact on trade with the United States in the next year or two. Rather, the basic constraints on the trade – particularly difficulties in generating Yugoslav exports – will continue to rule. Except in years when it had large imports of agricultural supplies, Yugoslavia since 1966 has come reasonably close to balancing its trade with the United States. This was true even when domestic economic policy was expansive in 1968-69. Yugoslavia's recent import liberalization probably will not have a significant effect on US sales. As in the liberalization of 1967, the unrestricted list covers mainly raw materials and semifinished manufactures, as opposed to consumer manufactures and other finished goods which might offer new export opportunities for the United States.

5. The IFC of New York is one of the consortia of subscribers to the International Investment Corporation for Yugoslavia which was set up in 1970 to promote and underwrite Western investment in jointly owned enterprises in Yugoslavia.

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27. Over the long run, US-Yugoslav trade should benefit from recent US steps to liberalize credit facilities and to support joint ventures in Yugoslavia. Yugoslavia would have a better chance of absorbing additional credit as well as enticing US and other Western firms into large-scale ventures if Belgrade could create a less unstable economic and political setting. Unquestionably, one of the greatest drawbacks to investing in Yugoslavia has been coping with the fits and starts of market conditions and adjusting to -- or even keeping informed of -- constant changes in federal and republic credit, price, and trade policy. The prospect of instability, especially in a post-Tito Yugoslavia, far outweighs the problems of operating under the Yugoslav system of workers' self-management and dealing with local, regional, and state government officials. As Prvoslav Rakovic, Director of the Fiat-sponsored automobile factory "Crvena Zastava" in Kragujevac (the largest joint investment in Yugoslavia) said in November 1971:

> Does anybody know today under what conditions we are going to carry out our business in several months' time? And to say nothing about what will happen after several years?

28. Under Sirotkovic, even amid the constant political turmoil, some headway has been made toward a more complete -- if more complex -- set of short-run measures to deal with instability. For the time being at least, Sirotkovic also seems to have convinced government, business, and the public that achieving greater stability is a longer run proposition and that "no magic solutions are expected to be found to solve all the problems of instability and insolvency." Sirotkovic, however, will find it difficult to establish a consistent economic policy, especially one that could survive pressures for relaxation during prosperity. If he fails, he, or his successor, is likely to be back in Washington for more than general economic discussions.

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